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THE TWELVE BEST REASONS FOR COMMODITY PROGRAMS: WHY NONE STANDS SCRUTINY

by
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The thesis of this paper is that the traditional justifications for farm commodity programs no longer stand scrutiny. Programs either fail to meet needs of agriculture and society or meet them cost-ineffectively. Programs are an anachronism of the 1930s and need to be phased out. I have elsewhere proposed a 10-year phaseout minimizing pain to those made worse off by adjustments and restructuring of programs.

This paper scrutinizes the following reasons for farm programs: (1) equity and fairness, (2) economic efficiency, (3) chronic low returns on resources, (4) food security, (5) risk, (6) countervailing foreign subsidies, (7) preserving family farms, (8) preserving rural communities, (9) protecting the environment, (10) maintaining a fair share of federal government benefits, (11) sustaining farmland values, and (12) "they work."

Justifying Programs

1. Equity and fairness

Measured by income and wealth, American farmers are no longer "have nots":

- Income per farm household equals or exceeds that per nonfarm household. Income parity is the culmination of long-term structural change to larger farms, more off-farm employment, and increased productivity. A phaseout of farm programs would be only a transitory setback in this trend.
- Wealth of farmers (over $300,000 per household) averages several times that of consumers (less than $100,000 per household) and taxpayers (some $150,000 per household). Net worth of commercial farms, defined as those with annual sales of over $100,000, averages nearly $1 million per farm and they receive 70% of commodity program payments.

Monetary benefits of commodity programs have been capitalized into land values and show up in higher rent, thereby passing program benefits to landlords. I do not have wealth data on farm landlords, but on average they are probably more wealthy than operators. Based on ownership of farm real estate in 1992, 37% of commodity program benefits (over $5 billion annually) go to *nonfarm* landlords.

Some contend that transfers to agriculture are justified to alleviate farm poverty. The poor do not survive long in commercial agriculture to which commodity programs are aimed. The poor mainly operate small farms or are hired farm workers who have few commodities to sell and little to gain from commodity programs. Human resource development programs are more effective means to alleviate poverty.

The conclusion that farmers have achieved income/wealth parity with nonfarmers has profound policy implications. With farming no longer a welfare case, producers can afford to pay for means to cope with risk and other "unique" problems of agriculture. A government that pays risk insurance premiums for producers gets more of what it pays for (instability and farming of fragile, erosion-prone marginal lands) and less of what the public wants (stability and environmental protection).

However, farmers should not necessarily pay for what the public wants from agriculture that the market will not provide. Possible candidates are food security, family farm preservation, and "downstream" environmental protection discussed later.

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2. *Economic efficiency*

Some contend that our agriculture is efficient because commodity programs raise productivity. Our consumers spend a smaller share of their income on food than do consumers in any other nation, and that low ratio has been achieved during the six decades under commodity programs. The gains were made because of rising farming productivity and rising consumer real income and not because of commodity programs.

Evidence that commodity programs retarded rather than advanced efficiency and productivity is compelling:

- Removing a valuable resource, land, from production reduces productivity and international competitiveness.
- Empirical evidence reveals that productivity gains in agriculture are the product of public and private investments in research, education, extension, and infrastructure rather than of commodity programs.
- Commodity programs typically reduce the nation's net income by $5 billion annually due to resources used unproductively for political lobbying, program administration, cropland set asides, and other market interventions. Because producers gain $5 billion less than consumers and taxpayers lose, the nation's income and federal budget deficit would improve by phasing out commodity programs.

Returning idled acres to production would initially expand food output and reduce food prices. With time, some food prices would rise to provide production incentives previously provided by government programs. Total consumer food expenses would not change much because lower prices for sugar and peanuts would offset any higher prices for grains. However, the overall cost of food and fiber (including taxpayer outlays for farm programs) would drop at least $10 billion annually.

- Grains, peanuts, sugar, fiber, and dairy commodities are not *public goods* such as national defense warranting government interventions for market efficiency. Farm commodities are *market goods* because they possess characteristics (rival, exclusionary, transparent) required for markets to work well.

The half of U.S. agriculture that does not receive support is at least as efficient as the half covered by programs. American farm commodity markets work. One reason is because they are supported by strong science and efficient agribusiness. However, interventions in agriculture sometimes are warranted to provide public goods such as basic research, education, and infrastructure.

3. *Farm resources are predestined to earn low returns in the absence of commodity programs*

This argument for continuing farm programs takes many forms. One is that farmers are unique: They are *price takers*, unlike other sectors that are *price makers* able to control their economic destiny. Another assertion is that a competitive farming sector sandwiched between a "monopolistic" input supply sector and a "monopsonistic" marketing sector can never earn a fair return on resources. Farmers, it is said, are exploited by an agribusiness sector reaping profits that should go to farmers. These and related conjectures are myth:

- Most Americans are price takers. Even General Motors and IBM are price takers, unable to arbitrarily raise their prices without sacrificing profits.
- The American agribusiness sector has an exemplary record of high performance. American farm products are delivered abroad, for example, for less cost per ton mile than products of any other nation.
- Farmers are served by an extensive system of agribusiness cooperatives that serve as a yardstick and alternative source of inputs and markets to private agribusiness.
- Even if input supply and product marketing firms were imperfectly competitive and earning high profits, the farming sector would not earn low returns if resources are mobile. And farming resources such as labor now are mobile.
- Most importantly, resources on reasonably well managed commercial farms do not earn low returns. On average, assets on such farms earn returns of 10% and more on investment – comparable to like resources elsewhere in the economy. That outcome is precisely what one would expect from equilibrium in an efficient market.

The author of a recent newspaper article justify farm commodity programs because "... new [farming] technology results in lower consumer prices instead of higher producer profits as in other industries" apparently was unaware that commercial farms on average make normal profits despite rapid productivity gains. Real income per capita of farm people increased more than 10-fold since 1930, a period of unprecedented technological progress (see references at end of paper).

The *current* rate of return on farm assets has averaged about 4% for several decades, well below typical returns elsewhere in the economy. For various reasons, aggregate farm rates of return appear to be low when they are not and appear to provide evidence of resource disequilibrium when they do not. One reason is because published rates of return combine well-managed commercial farms earning returns comparable to those elsewhere with small and poorly managed farms earning low and even negative rates. For many small farms, amenities of rural living, tax advantages, and prospects for capital gains offset low monetary returns. That is, monetary plus nonmonetary returns on small farms are favorable enough so that owners keep their resources in farming.

Another reason farm aggregate average rates of return appear to be low when they are not is because returns come in two forms: current return and capital gain. Current returns on farm assets average about 4% per year as indicated above. Capital gains traditionally have kept pace with and compensated for inflation in farming so that the current return is also the real return. Many farmers and others are willing to commit their resources to agriculture for a real, inflation-compensated return of 4%. And, as indicated earlier, returns on the well-managed commercial farms that set land prices average double that rate.

The price system will not provide parity returns on small, poorly managed farms any more than it will on small, poorly managed nonfarm businesses. Unless commodity programs are carefully targeted, they also will not provide uneconomic size farms with a "fair" return. Direct payments targeting such farms may appear to be an attractive alternative to current programs, but have drawbacks. One is that attempts to target have failed in the past and will be prone to fail again. Another is that the public is wary of subsidizing inefficiency.

4. *Food security for the U.S.*

The preamble to the 1990 farm bill says its purpose is "to ensure consumers an abundant supply of food and fiber at reasonable prices." For several reasons, food supplies would not be threatened by terminating commodity programs:

- Food security is amply provided by the large buffer this nation enjoys from a productive agriculture, food export surpluses, ability to feed less and slaughter more livestock, and a strong private sector that would provide buffer stocks and other food security functions if the government did not crowd it out. If intervention is deemed necessary, a simple and relatively unobtrusive means would be to expand the 4 million ton emergency wheat reserve to be used in times of special need as judged by the President.
- The half of crops and livestock not covered by commodity programs are provided in abundance and with favorable returns on resources. If government interventions were terminated, after an adjustment period the performance for covered commodities would be as favorable. Consumers do not anguish over shortages of tomatoes, potatoes, eggs, broilers, and other commodities not under government control. However, programs indirectly affect such noncovered commodities, for example, by raising costs of feeding animals.
- Tobacco and cotton programs can hardly be justified on food security grounds.
- American consumers spend only 2.5% of their income for farm food ingredients. Even the unprecedented 42% farm price jump in 1972-73, if repeated today, would add only 1 percentage point to the share of income consumers spend on food. Studies of risk preferences reveal that most consumers prefer the market-oriented policy of low food prices most of the time (but an occasional food price spike) to high food prices all the time with price supports.
- Central planning in the U.S. and elsewhere has had a disappointing record of managing food supplies. Excessive government stocks depressing farm prices in the 1950s and 1960s, and excessive acreage withdrawal in 1983 are examples of failures of central planning. A global movement is underway toward greater reliance on markets.
- A shift away from acreage reduction programs (ARPs) and towards direct payments (marketing loans and deficiency payments) has reduced government buffer stocks. Meanwhile, the continued government presence in agriculture discourages private buffer stocks and forward markets that enhance food security. Thus commodity programs no longer provide buffer reserves they once did, and may increase food insecurity by driving out private holders of buffer stocks. If the government maintains its presence in farming but no longer idles cropland nor holds buffer stocks, its contribution to food security will

be negligible and perhaps negative.

5. High risk

Risk is the premier economic problem faced by commercial agriculture, but the presence of risk does not justify commodity programs:

- Risk is not a *prima facia* case for subsidies – Las Vegas and lotto gamblers along with Wall Street and futures market speculators are more often taxed than subsidized.
- Risk is a serious irritant but not business-life threatening for most farm producers. Many successfully pursue strategies of diversification (e.g., off-farm earnings), flexibility, liquidity, forward marketing, private insurance, and the like with success.
- When operators choose to farm, they surely are aware of the risks endemic to the industry.
- Risk shifting measures such as vertical coordination have been successfully implemented especially among farm commodities not covered by government supports.
- New instruments such as state crop yield futures contracts and cooperatives to pool risks of small producers would bloom in the absence of government commodity programs.
- Government programs have discouraged innovation of private risk shifting instruments and their use by producers. Research at Ohio State University and elsewhere indicates that the private trade would hold socially optimal buffer stocks in the absence of government commodity programs.[1]
- Risk is not unique to farming. Other major elements of the economy also face severe risk, and, in fact, small businesses have higher failure rates than farms. Yet, despite or because of minimal government intervention, small nonfarm business has been a vital, dynamic, and growing sector.
- Government risk management often fails. Provision of disaster payments and federal all-risk crop insurance has been an administrative nightmare and subject of abuse by farmers. Reports are too common of disaster payments for more acres of a crop in a county than were ever harvested even in good years. Few farmers voluntarily buy federal crop insurance despite heavy subsidies. Nowhere in the world are farmers sufficiently risk averse to pay the full cost of all-risk crop insurance. Government payment of insurance premiums encourages farmers to raise output variation to maximize subsidies and encourages cropping in marginal farming areas with fragile soils that in many cases should be in grass or trees.

Partly to reduce risk in the dairy industry, the government has fostered a complex marketing order system with multiple prices featuring a higher fluid milk consumption price and a lower manufactured milk price. The multiple-price system "taxes" fluid milk consumers. The resulting blend price paid to producers induces more supply than the market will absorb. Surpluses generated by this system and by government price support have been removed from markets by the Commodity Credit Corporation. The program has been justified by the need to maintain orderly markets and assure adequate seasonal and annual milk supplies by region. Large administrative, lobbying, and resource misallocation costs have been incurred.

Is the program necessary to reduce risk, provide food security, and provide bargaining power to producers? Modern storage, handling, transportation, and communication technology now permits milk to be stored for long periods and transported long distances at low costs that will avoid seasonal and area shortages of dairy products. Large producer cooperatives give dairy producers bargaining power when facing processing and distribution firms. Thus modern technology and market relationships can provide an orderly market and adequate dairy supplies with deregulation, thereby saving taxpayers, consumers, and agribusiness billions of dollars.

6. Countervailing foreign subsidies

This justification for programs is stated as "We must subsidize if other countries subsidize" or "We can compete with foreign producers but not with foreign governments."

Such statements do not stand scrutiny:

- Other countries including New Zealand, Canada, Australia, and the European Union (EU) are cutting back agricultural subsidies unilaterally.
- The completed Uruguay Round of multilateral trade negotiations requires countries to cut their agricultural export quantity subsidized by 21% and export subsidy value by 36% by year 2000. Our Export Enhancement Program of subsidies may have helped us to get a better deal out of the Uruguay Round but future U.S. export subsidies are unlikely to influence EU behavior, the chief villain in subsidized trade. Meanwhile, continued U.S. export subsidies alienate our friends such as Canada and Australia as we take over markets because they

cannot afford to match our subsidies.

- Studies summarized by the General Accounting Office indicate that the Export Enhancement Program had a low payoff even before completion of the Uruguay Round. It is less cost-effective than direct payments in raising farm income. It raises domestic prices relative to world prices, inviting imports of durum wheat from Canada.
- Importers such as the Former Soviet Union gain from our food export subsidies while our nation (especially taxpayers) loses.
- Continuing farm subsidies detract from funding of high-payoff agricultural research for agricultural productivity gains that are the core of our international competitiveness.
- International trade models indicate that consumers, agribusiness firms, and taxpayers gain more than producers lose from terminating trade distortions. Models of the economy typically show U.S. national income losses of $4 billion or more annually from trade distortions induced by commodity programs. These results show as large or larger gains in national income from unilateral than from multilateral liberalization. The fact that the U.S., EU, and other major traders liberalized their policies before rather than after the Uruguay Round agreement strongly suggests each country gained from opening markets whether or not other countries opened their markets. However, because multilateral liberalization lifts world prices, producers are better off from multilateral liberalization than from unilateral liberalization.
- American production of peanuts, tobacco, sugar, cotton, and rice faces competition mainly from countries too poor to provide effective subsidies or government competition warranting countermeasures by the U.S. Most would end their subsidies if we would end our subsidies.

7. Preserve the family farm

Commodity programs have not saved the family farm. Empirical models provide some insights:

- According to my empirical analysis, commodity programs have no major impact on farm size and number, but may modestly increase size and decrease numbers in the long term. Programs provide security and capital, encouraging farmers to leverage equity to buy and consolidate a neighboring farm and purchase additional machinery to cut labor needs and expand operations.
- Termination of programs "overnight" could drop land values by $100 billion and cause many financially vulnerable family farms to fail. A 10-year transition program can minimize adjustment difficulties.
- In the 1980s, the rate of decline in farm numbers was twice as fast in Japan as in the U.S. Yet, Japan was supporting prices at four times U.S. price levels. The European Union with very high supports also has had a higher rate of farm outmovement than the U.S. in recent decades. The major reason for the slower U.S. rate was because we made our adjustment earlier – in the 1950s and 1960s. Commodity programs could do more to preserve farms of choice but a major restructuring would be required to target small and mid-size family farms.
- Farm size and numbers are determined primarily by technology. Commodity programs can temporarily run against the tide but eventually markets and technology prevail.
- Any farm people displaced by ending commodity programs are not necessarily worse off. An Oklahoma study of former farm operators who exited in mid-career found that the number who said they were better off outnumbered those who said they were worse by a four to one ratio.

8. Preserve rural communities

After experiencing net inmigration in the 1970s and net outmigration in the 1980s, rural areas have again returned to net inmigration in the 1990s. Many feel that generous commodity programs are a useful way to further stimulate the rural economy. Several considerations argue against that conclusion:

- Fewer than one-third of the nation's some 2,400 rural counties are farm-dependent, that is, receiving over 20% of their income from farm related earnings. These counties contain only 7% of the nation's population. Most of these counties are in the Great Plains. The economic base of most rural communities is service industries and manufacturing rather than farming.
- Less than 10% of the 60 million rural residents live on farms. Only one-third of farm households are full time farmers, and fully 87% of farm household income came from off-farm sources in 1993. Thus farming is the direct economic base for less than 5% of rural workers (full-time equivalent) and for less than 10% if multipliers are considered for local nonfarm jobs created by farm jobs.
- Farm dependent rural communities are more

affluent than rural communities dependent on other occupations. And my research with David Henderson indicates that increasing farm income can hasten the shift of shopping from nearby small towns to more distant urban areas offering more variety at lower prices.

- Other, more cost-effective state and federal strategies such as investment in more hours of schooling per day and per year will serve the people in rural communities better than will commodity programs.

In summary, neither efficiency, equity, nor cost-effectiveness argue that commodity programs are a wise route to rural development.

9. Protect the environment

Although the market alone will not protect the environment, current commodity programs are an inadequate delivery system for several reasons:

- Conservation Compliance (CC) is a success story but omits half of all cropland – that on farms not participating in government crop programs. Surveys indicate that CC is generally well received by producers, but cannot be comprehensive if tied to commodity programs.
- Commodity programs discourage rotations and encourage excessive application of pesticides and synthetic fertilizers per acre on crops.
- The Conservation Reserve Program is not cost-effective to protect the environment. Many acres in it have no environmental hazards. Much land classified as "highly erodible" can be farmed with modern conservation tillage and other "best practices" without harm to the environment. I have proposed a 20-year or permanent Cropland Easement Program (CEP) to remove approximately 20 million acres of cropland from production that cannot be farmed with conservation tillage at acceptable erosion rates or that poses water quality problems. The CEP would allow haying, grazing, forest, wildlife, or recreation use.

Conservation Compliance (CC) needs to cover *all* cropland having environmental hazards. Some current commodity program funds would be reallocated to pay for environmental structures such as fences protecting grass filter strips. The public is not necessarily obligated to compensate farmers for extending Conservation Compliance because (1) modern conservation tillage practices now permit CC with no loss of profit or output on most land, (2) producers in most instances are being asked only to do what is in their interest (e.g., saving soil) or to stop "downstream" damage they were causing other farmers or nonfarmers, (3) costs to individual producers of CC are very difficult to estimate and hence to compensate, and (4) a Conservation Easement or Conservation Reserve Program needs to attend CC removing cropland from production that cannot be cropped at acceptable soil erosion tolerance or water quality levels using best practices. The Cropland Easement Program would compensate farmers and avoid "taking."

10. Maintain a fair share of government benefits for farmers

Those who contend that commodity programs are justified to ensure that farmers receive a fair share of federal benefits emphasize the declining farm portion of the federal budget. That share has fallen from 4% in 1950 to 1% in recent years. In contrast, farming accounts for nearly 2% of the nation's population and gross domestic product (GDP).

Several considerations argue against the principle that farmers should receive the same share of the federal budget as their share of population and GDP:

- The vast majority of federal spending is for services rendered such as defense and interest on the debt, or for insurance such as social security and medical care. These alone constitute two-thirds of federal outlays. Most other outlays are not subsidies to specific sectors. If we consider only federal budget subsidies to industries and arbitrarily allocate 2% of that to agriculture, the industry will receive far less than the annual $10-$15 billion for farm subsidies received in recent years.
- The proper way to cut the federal budget is to prune spending that is inequitable, inefficient, and not effective in addressing the nation's needs. In contrast, spending that has a high payoff in meeting the nation's needs that the private sector will not supply warrants expansion even as overall spending is cut. By that standard, commodity programs need to be pruned while basic research to raise food resource productivity needs to be expanded. Statements such as "agriculture will accept cuts proportional to those in the rest of the budget," or "agriculture has already taken its share of cuts" may be good politics but are not sound economics.

11. Sustain farmland values

Expectations of continuing farm commodity programs have caused some $100 billion of such benefits to be capitalized into land prices, or up to 15% of total farmland value.[2] The percentages are higher in cotton, rice, and wheat areas where benefits have been especially generous.

Maintaining these capitalized benefits is not a case for continuing farm programs for several reasons:

- Preserving programs without merit just to avoid capital losses makes no more sense than maintaining unneeded military bases and personnel to avoid adjustments.
- Commodity programs are of little value to new owners, renters, operators, and farm laborers. Benefits have gone mainly to those who owned land when programs were initiated. However, termination of programs will be painful to the new owner-operators because they will experience decapitalization of real estate assets. The impact is dampened somewhat because many land market participants anticipated that programs could not be sustained and restrained their land bids accordingly in recent years.
- Adjustments to the market need not be traumatic. Program support parameters have been reduced 50% since 1985 but real income per capita on farms has risen. Phasing programs out over 10 years as I propose would mean loss of land assets of about 1.5% annually for 10 years, other things equal. Over the long term, land prices have kept pace with inflation and are expected to do so in the future, *ceteris paribus*. If inflation averages 4% annually over the next decade, land prices may rise only 4 - 1.5 = 2.5% per year with program phaseout, a disappointing but not devastating adjustment compared to the 6% average annual drop between 1982 and 1987.

12. Commodity programs work

Politicians and commodity groups frequently defend programs by saying "they work." The meaning of "they work" is unclear but probably means programs meet the needs of their advocates.

- Failure of the previous 11 justifications to stand critical scrutiny is evidence programs do not work to meet the needs of the public at large.
- Even the egregiously worst agricultural policies the world over have avid defenders. That is because someone gains from policies that fail the most elementary tests of equity and efficiency. The programs work to serve special interests but not the public interest.

Conclusions

Commodity programs have lost their economic, social, and environmental rationale and now must rely for sustenance on political power. The nation can no longer afford upper middle class welfare, – 70% of programs benefits go directly to commercial farmers (sales over $100,000 per year) who on average are millionaires. Land owners are the ultimate beneficiaries of programs and these owners on average may be more wealthy than operators, and many are not farmers.

To avoid severe adjustment strains, programs need to be gradually phased out over a 10-year period. Announcing the phaseout in advance alerts investors to stop capitalizing benefits into land and to begin adjustment to a market economy. The government could afford to be generous in providing training, job information, relocation assistance, counseling, and the like for any who leave farming rather than continue the far more costly commodity programs to maintain land price.

The case for ending "no federal cost" programs for sugar, tobacco, peanuts, and marketing orders for milk are at least as strong as for ending grain and cotton programs. "No federal cost" programs "taxing" consumers are more regressive than programs taxing taxpayers. That is because taxpayers on average are more wealthy than consumers. Also, programs providing decoupled deficiency payments from taxpayers distort markets and reduce national income less than programs distorting markets with mandated high prices.

Endnotes

1. Based on econometric models, sizable changes in interest costs to reflect high risk premiums demanded by private versus public buffer stock holders produced very modest changes in the coefficients of variation in food grain prices and consumption.

2. Various combinations of investors' discount rates, expected annual benefit, and duration of commodity programs can give $100 billion capitalization. Examples are expected benefits of $20 billion per year discounted at 15% for 10 years; or expected benefits of $10 billion per year for 15 years discounted at 5%.

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